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SIPDIS

STATE FOR AF/S AND AF/EX
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER
USDOC FOR AMANDA HILLIGAS
TREASURY FOR OREN WYCHE-SHAW
PASS USTR FLORIZELLE LISER
STATE PASS USAID FOR MARJORIE COPSON

E. O. 12958: N/A

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SUBJECT: IMF Advocates Devaluation

1. Summary: International Monetary Fund (IMF) Southern Africa Chief Doris Ross has called on the GOZ to devalue, spend less and restart tripartite discussions. She also predicted the IMF Board of Governors would neither restore privileges nor expel Zimbabwe from the lending body as a result of these talks, freezing the country's current suspended status. While the Ross delegation prescribed sound medicine, we do not yet see a GOZ willingness to swallow the pill. End summary.

2. Ross' IMF delegation held Article IV consultations in Zimbabwe March 17-31. Reserve Bank Governor Gideon Gono has repeatedly stated he wants to lead Zimbabwe back to IMF reengagement. At a diplomatic briefing, Ross summarized her delegation's findings for us. Highlights follow.

Foreign Currency Generation

3. Concerning forex inflows from exports, Ross lamented that her crew had not "gotten to the bottom of the story" despite repeated queries. She estimated the GOZ was sending at least half its export proceeds to underfunded currency auctions, where it sells US\$16 million each week to importers at a preferential, overvalued rate. She did not believe the current supply of forex to the auction system was sustainable. However, she argued the auctions, introduced in January, provided a handy mechanism for the RBZ to depreciate its currency to reflect market conditions, even if the RBZ has not yet deployed it effectively. Only an export rebound could lead a recovery, Ross stressed.

Fiscal Policy

4. Ross complained of fiscal indiscipline, noting the 2004 budget "was not conducive to bringing inflation down." Last year's budget deficit reached 7.5 percent of GDP. While high inflation continually drives down the rate of domestic debt on borrowed funds, she expects the GOZ will require a supplementary budget this year. Government ministries and parastatals are still enjoying very cheap forex.

5. The IMF advised the GOZ to adapt its tax collection to this high-inflation environment, suggesting both that firms pay estimates during the year and that the GOZ readjust rates more frequently to account for bracket creep. If the GOZ abolishes its 25 percent retention of export earnings, it will face a significant budget shortfall. On the other hand, the 2004 budget did not account for a 5-fold increase in customs collections on imports, which came about when Gono decided to assess goods using the new auction rate. The IMF bemoaned inconsistent terms of domestic borrowing, where the RBZ's T-bills compounded either daily, monthly or quarterly while the Finance Ministry's own bonds compound daily. Due to high inflation, the means of compounding causes effective rates to vary wildly.

Agricultural Rebound

6. Ross opined that mining might some day lead a recovery, since there is no short-term means to reinvigorate post-land reform agriculture. Special Affairs Minister John Nkomo, who now has the GOZ lead on land reform, told the delegation he wanted to prepare by May a register of farm occupants and end multiple farm holdings. Nkomo said he sought to introduce 99-year leases for large-scale resettled farms (A2s) as well as communal farms that could serve as collateral for bank loans.

Other Findings

7. In addition, the IMF group added:

- The GOZ should reconvene Tripartite talks with business and labor. The GOZ has no formal dialogue with the Zimbabwe Confederation of Trade Unions at this time.
- The IMF foresees a GDP decline of 4-5 percent in 2004, significantly below the GOZ's own 8-9 percent estimate. Partly, a GOZ double counting of certain service charges may explain the difference. Although fodder for methodological debate, the IMF now believes GDP has receded 30 percent in five years, versus alternative estimates as high as 40 percent.
- There are still too many banks for Zimbabwe's shrunken economy, even after the current shakedown. Due to negative borrowing rates, however, the sector has a low ratio of non-performing loans.
- Zimbabwe may soon reach Heavily Indebted Poor Country (HIPC) levels, given current debt-to-export levels. If the country returns to good standing with the IMF, it will almost certainly have to restructure external debt.
- The Finance Ministry and RBZ should better coordinate economic policy. Since Gono became RBZ governor in December, the Finance Ministry's role has become marginal.
- Gono will make another policy statement in mid-April. The besieged export sector hopes for relief at that time.
- By next year, the GOZ's entire IMF debt - currently \$310 million - will have fallen into arrears. Ross has been told a symbolic payment of US\$6 million is in the pipeline, and that the GOZ would pay missing portions of similar symbolic payments begun since 2001.
- In conclusion, Ross speculated that IMF governors would neither expel Zimbabwe nor restore its privileges, although she noted that it would be IMF management recommending to the Board and the Board deciding.

Comment

18. Ross, who has learned much about Zimbabwe since her first consultations in 2003, carried the right message - export promotion, fiscal control and dialogue. She would not speculate upon GOZ receptivity. Although government interlocutors asked anxiously when they might access IMF money, this Government probably accomplished all it could by staving off expulsion. On the other hand, we were disappointed the eager-to-reengage RBZ is still unwilling to handle data objectively and transparently. The GOZ treats weekly export revenues as a state secret, invents unfounded maize harvest projections and offers no public accounting of resettled farmers. We do not believe it will act decisively to turn the economy around until it confronts these ghosts.

Sullivan